

**ORIGINAL**

DOCKET FILE COPY ORIGINAL

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

RECEIVED

SEP 23 1999

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matters of )  
)  
Ameritech Corporation Telephone Operating )  
Companies' Continuing Property Records Audit )  
)  
Bell Atlantic (North) Telephone Companies' )  
Continuing Property Records Audit )  
)  
Bell Atlantic (South) Telephone Companies' )  
Continuing Property Records Audit )  
)  
BellSouth Telecommunications' Continuing )  
Property Records Audit )  
)  
Pacific Bell and Nevada Bell Telephone )  
Companies' Continuing Property Records Audit )  
)  
Southwestern Bell Telephone Company's )  
Continuing Property Records Audit )  
)  
U S West Telephone Companies' Continuing )  
Property Records Audit )  
)

CC Docket No. 99-117

ASD File No. 99-22

**MCI WORLDCOM COMMENTS**

MCI WORLDCOM, INC.

Alan Buzacott  
1801 Pennsylvania Ave., N.W.  
Washington, DC 20006  
(202) 887-3204

September 23, 1999

## TABLE OF CONTENTS

I.	Introduction and Summary .....	1
II.	The Audits were Planned and Conducted in a Professional Manner .....	7
III.	The Audit Scoring was Overly Generous to the RBOCs .....	12
IV.	The Audit Reports' Statistical Extrapolations are Valid and Support the Audit Reports' Conclusions .....	23
V.	Undetailed Investment Must Be Considered Missing .....	26
VI.	Customers Have Been Harmed, and Continue to be Harmed, by the RBOCs' Overstatement of Investment .....	34
VII.	The Commission Should Take Immediate Enforcement Action .....	40
VIII.	Conclusion .....	42

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

<b>In the Matters of</b>	)	
	)	
<b>Ameritech Corporation Telephone Operating</b>	)	
<b>Companies' Continuing Property Records Audit</b>	)	
	)	
<b>Bell Atlantic (North) Telephone Companies'</b>	)	
<b>Continuing Property Records Audit</b>	)	
	)	
<b>Bell Atlantic (South) Telephone Companies'</b>	)	<b>CC Docket No. 99-117</b>
<b>Continuing Property Records Audit</b>	)	
	)	<b>ASD File No. 99-22</b>
<b>BellSouth Telecommunications' Continuing</b>	)	
<b>Property Records Audit</b>	)	
	)	
<b>Pacific Bell and Nevada Bell Telephone</b>	)	
<b>Companies' Continuing Property Records Audit</b>	)	
	)	
<b>Southwestern Bell Telephone Company's</b>	)	
<b>Continuing Property Records Audit</b>	)	
	)	
<b>U S West Telephone Companies' Continuing</b>	)	
<b>Property Records Audit</b>	)	
	)	

**MCI WORLDCOM COMMENTS**

MCI WorldCom, Inc. (MCI WorldCom) hereby submits its comments on the Notice of Inquiry in the above-captioned proceeding.

**I. Introduction and Summary**

The continuing property record (CPR) is an indispensable auxiliary record that substantiates the investment recorded in the Uniform System of Accounts (USOA) plant

accounts of the telephone company.<sup>1</sup> The USOA accounts are, in turn, the foundation for the entire cost allocation structure upon which interstate and intrastate rates are based.<sup>2</sup> If the CPR is not maintained in such a manner that the amounts recorded in the plant accounts reflect the actual plant in service, then the Commission and state regulators cannot rely on these plant accounts or the results of subsequent stages in the cost allocation process -- regulated/nonregulated cost allocations, separations, or Part 69 cost allocations -- for any regulatory purpose.

The Accounting Safeguards Division audits of the Regional Bell Operating Companies' (RBOCs') basic property records and continuing property records demonstrate that the RBOCs have failed to comply with the Commission's property record rules and that their central office equipment (COE) plant accounts are, as a result, overstated. The amount of the overstatement is staggering: over 5 billion dollars in investment shown on the RBOCs' books is not associated with assets that are used and useful in the provision of telecommunications service.<sup>3</sup>

---

<sup>1</sup>GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit, Memorandum Opinion and Order, 13 FCC Rcd 9179, 9180 (1998) (GTE CPR Audit Order).

<sup>2</sup>See, generally, Letter from William E. Kennard, Chairman, FCC, to Senator Ted Stevens, Chairman, United States Senate Committee on Appropriations, September 14, 1999.

<sup>3</sup>See Attachment 1 for a summary of the auditors estimates. The \$5 billion in missing investment consists principally of \$2.9 billion in missing hard-wired central office equipment and \$1.9 billion in missing "undetailed" investment.

The audits were planned and conducted in a professional manner, consistent with all applicable accounting standards.<sup>4</sup> The auditors used a statistically valid sampling plan, “scored” the sampled CPR line items in a consistent manner, and developed statistically valid estimates of the percentage of incorrect CPR line items and the dollar value of the missing equipment. RBOC attacks on the professionalism of the auditors are nothing more than an attempt to divert attention from the real issue: the RBOCs’ massive and longstanding violations of the Commission’s rules.

In their attempts to undermine the credibility of the audits, the RBOCs have misrepresented the audit procedures in important respects. Contrary to the RBOCs’ claims, the auditors: (1) did not score items as “missing” merely because they had been moved to another location in the central office; (2) did not score items as “missing” merely because they were embedded in larger items; and (3) did not score items as “missing” merely because they had been removed from service after the CPR listings were printed, but before the audits were conducted. Items were scored as “missing” only when neither the auditors nor RBOC engineers were unable to find the sample item anywhere in the central office.

Similarly, there is no basis for the RBOCs’ claim that the auditors somehow “ignored” or “refused to consider” requests to “rescore” items that had been scored as

---

<sup>4</sup>MCI WorldCom bases its analysis of the audit procedures on the Accounting Safeguards Division audit reports, the RBOCs’ responses to these reports, and on inspection of the Bell Atlantic North and Bell Atlantic South audit workpapers by MCI WorldCom and Mr. James K. Loebbecke. MCI WorldCom reserves the right to supplement these comments after inspecting workpapers and supplemental submissions related to the other RBOC CPR audits.

“missing” during the field audits. The auditors reviewed carefully all such RBOC explanations and supporting documentation and, if the documentation suggested a valid reason why the RBOCs had been unable to find the item on the day of the audit, rescored the item in the RBOCs’ favor. The reason that most items were not rescored is simple: the RBOCs’ explanation and documentation were, in almost all cases, completely insufficient.

The longstanding deficiencies in the RBOCs’ hard-wired COE basic property records and continuing property records have caused RBOC customers to be overcharged by hundreds of millions of dollars per year. Overstated plant balances inflated the rates used to initialize the Commission’s price cap plan, and thus have inflated all subsequent price cap rates, up to and including the RBOCs’ current rates. And, of course, inflated RBOC revenue requirements have inflated intrastate rates as well, both in the states that continue to use rate of return regulation and in those that have switched to price cap regulation.

As staggering as the audit reports’ estimate of \$5 billion in missing equipment is, this estimate may actually understate the amount of missing RBOC equipment:

*First*, the auditors’ “scoring” of the sample items consistently gave the benefit of the doubt to the RBOCs. If there was even a mere “possibility” that the sample item was somewhere in the central office, the auditors scored the sample item as “unverified,” and excluded it from their estimates of the missing equipment. Only the very narrowly-defined category of “not found” items was used in estimating the dollar value of the missing equipment.

*Second*, the \$5 billion figure does not include an additional \$1 billion in questionable investment shown on the RBOCs' books with no description other than a vague "unallocated other costs" entry. The audit reports note that the auditors "do not have sufficient documentation to determine the nature of the costs described . . . as Unallocated Other Costs."<sup>5</sup>

*Third*, the CPR audits that have been completed to date cover only the RBOCs' "hard-wired" Central Office Equipment (COE) investment, which represents only about one-quarter of the investment on the RBOCs' books. Still to be audited are plug-ins, which account for another quarter of the RBOCs' plant investment, and outside plant, which accounts for about one-half of the investment on the RBOCs' books. Significantly, the hard-wired COE "consists of permanent equipment requiring complicated installation such as telephone switches and circuit equipment," while plug-ins "are more easily moved from place to place."<sup>6</sup>

In addition to the direct effects on ratepayers, the RBOCs' misstatement of their COE plant balances has made it impossible for the Commission to rely on the RBOCs' reported costs for any purpose. As the Commission has noted, plant accounts play a vital role in monitoring financial results, calculating low-end earnings adjustments, determining productivity factors for price cap companies, defining and resolving stranded investment issues, determining the basis for jurisdictional separations, and

---

<sup>5</sup>Bell Atlantic North Audit Report at ¶ 31.

<sup>6</sup>*Id.*, ¶¶ 2, 14.

deriving inputs for forward-looking cost models for universal service, interconnection agreements, and access prices.<sup>7</sup>

Predictably, the RBOCs have argued that accounting costs, and thus Commission rules and oversight that ensure the accuracy of these costs, no longer serve any real purpose. Not only is the RBOCs' position without merit, but the RBOCs only advance this position when the accuracy of their reported costs is in question or when they are campaigning for the elimination of the Commission's accounting rules. In other proceedings, such as the Commission's access reform and local competition proceedings, these same (hopelessly inaccurate) "costs" are of tremendous importance to the RBOCs, as they argue that the Commission can take no action that would prevent them from "recovering" these "costs."

The Commission should immediately initiate enforcement proceedings by issuing an Order to Show Cause. The RBOCs should be required to reduce their price cap indexes (PCIs) to eliminate the effects of plant overstatement on the initial price cap rates. And, as recommended by the audit reports, the Commission should require the RBOCs to write off the missing investment from their COE accounts and bring their internal processes into compliance with the Commission's accounting rules.<sup>8</sup>

---

<sup>7</sup>GTE CPR Audit Order, 13 FCC Rcd at 9181-9182.

<sup>8</sup>Bell Atlantic North Audit Report at ¶¶ 42-46.



## **II. The Audits were Planned and Conducted in a Professional Manner**

The RBOCs' various attacks on the audit procedures and even the competence of the auditors are absurd. As is discussed in the affidavit of recognized auditing expert Mr. James K. Loebbecke, attached to AT&T's comments in this proceeding, the methodology and procedures used by the audit staff were more than reasonable, and fully complied with applicable professional standards.<sup>9</sup>

### **A. The Field Audits were Well-Planned**

Based on his examination of the audit reports, the RBOC responses to these reports, and the audit workpapers for the Bell Atlantic and Bell Atlantic-North/NYNEX audits, Mr. Loebbecke concludes that the audits were well-planned to achieve their objectives.

While the RBOCs attack the sample design used by the auditors, Mr. Loebbecke concludes that the sample design was valid and reasonable given the objectives of the audit and the large number of central offices and equipment items encompassed by the RBOCs' CPRs.<sup>10</sup> The two-stage stratified sampling plan used for the field audits is a standard approach to audits or other investigations of large multi-location organizations.<sup>11</sup> When there is a significant cost associated with travel to a given

---

<sup>9</sup>Affidavit of James K. Loebbecke at ¶ 2 (Loebbecke Affidavit).

<sup>10</sup>Id. at ¶ 5.

<sup>11</sup>Id.

location, as there was for the CPR audits, the two-stage stratified sampling approach is often more efficient than a simple random sample.<sup>12</sup>

Another RBOC claim that is without merit is that the auditors should have conducted a “two-way audit,” i.e., should have tested not only for CPR line items that were missing, but also for in-service items that had been omitted from the CPR.<sup>13</sup> The auditors had no reason to conduct such an audit -- ratepayers are only harmed if the LEC has equipment on its books that is not associated with equipment used and useful in the provision of telecommunications service. Ratepayers are not harmed if a LEC has for some reason neglected to record the acquisition of an asset.

There is, in any event, no reason to believe that the amount of equipment that the RBOCs have neglected to record on their books is significant. For obvious reasons, the RBOCs have every incentive to ensure that any investments are recorded. They have, by contrast, no incentive to ensure that retirements are properly recorded or otherwise ensure that their books are not overstated. Every inventory ever conducted by a local exchange carrier has found that plant “overstatement” far outweighs any “understatement.”<sup>14</sup>

---

<sup>12</sup>Comments of AT&T, CC Docket No. 99-117, September 23, 1999, Affidavit of Dr. Robert M. Bell (Attachment) at ¶¶ 9-11.

<sup>13</sup>See, e.g., Bell Atlantic Response at 9-10.

<sup>14</sup>See, e.g., Bell Atlantic-North Audit Report at ¶ 32 n. 47 (Bell Atlantic-North inventory revealed \$291 million in “overstatements” and only \$79 million in “understatements”).

## **B. The Field Audits were Conducted in a Professional Manner**

Mr. Loebbecke notes that the auditors field-tested their procedures, conducted themselves in a professional manner, and produced work product that is clear, careful and consistent.<sup>15</sup> He also finds that the auditors were well-supervised, and that their work was appropriately reviewed to ensure consistency and accuracy of results.<sup>16</sup>

Bell Atlantic's suggestion that the inspectors "missed equipment" because they were "non-engineers who . . . never were given the opportunity to understand what they were inspecting"<sup>17</sup> is simply without basis. Not only were the auditors well-prepared for their engagement, but the auditors were accompanied at all times by Bell Atlantic engineers whose responsibilities included the sampled central office.<sup>18</sup> To the extent that sample items could not be located during the field audit, it is because Bell Atlantic's own personnel could not find them. As the audit reports emphasize, equipment items were scored as "not found" only when "neither [the auditors] nor the company personnel could find the equipment . . . ."<sup>19</sup>

Similarly without merit is the RBOC claim that inspections were "cursory" or that items were missed because the time allotted to each central office inspection was too

---

<sup>15</sup>Loebbecke Affidavit at ¶ 4.

<sup>16</sup>Id.

<sup>17</sup>Bell Atlantic Response at 10.

<sup>18</sup>Bell Atlantic North Audit Report at ¶18.

<sup>19</sup>Id. at ¶21.

short.<sup>20</sup> For the inspection of a central office, the FCC auditors were divided into two teams, each responsible for inspecting only 18 sample items over the course of the day -- items that, under the Commission's rules, should be capable of being "readily spot-checked for proof of physical existence."<sup>21</sup> There has certainly never been any suggestion that the auditors rushed the RBOC personnel or left a central office while RBOC personnel were still searching for a sample item.

### **C. The Auditors Fully Considered All RBOC Rescoring Requests**

After the auditors completed the field audits, they gave the RBOCs ample opportunity to submit explanatory material as to the missing equipment. The auditors began reviewing the RBOCs' explanations as soon as the field audits were complete, and continued to accept and review the RBOCs' explanations and documentation for several months.<sup>22</sup>

One of the RBOCs' primary attacks on the audit process has been to claim that the auditors "ignored" or "refused to consider" their supplemental submissions.<sup>23</sup> Some of the RBOCs have even characterized the alleged failure of the auditors to take the

---

<sup>20</sup>See, e.g., Bell Atlantic Response at 10.

<sup>21</sup>47 C.F.R. §32.2000(f)(5).

<sup>22</sup>Bell Atlantic North Audit Report at ¶ 20. See also SBC Response at 23 n. 47.

<sup>23</sup>Bell Atlantic Response at 10; SBC Response at 2-3; U S West Response at 7.

RBOCs' explanations and documentation into account as inconsistent with GAAS and GAGAS.<sup>24</sup>

Contrary to the RBOCs' claim, the audit reports state clearly that the auditors "reviewed [the RBOC]'s explanatory material and adjusted [the] original results when [they] were convinced by the explanation and supporting documentation that the missing plant was actually in service."<sup>25</sup> This is confirmed by Mr. Loebbecke's review of the Bell Atlantic workpapers, in which he finds that the auditors carefully and conscientiously reviewed Bell Atlantic's explanations and documentation, and applied the rescoring standards consistently.<sup>26</sup>

The reason that the auditors left most of the scores from the field audit unchanged is that the RBOCs' explanations and supporting documentation simply failed to meet the rescoring standards. In the limited number of cases where the RBOCs' explanations and supporting documentation were adequate and convincing, the auditors rescored the sample item in the RBOC's favor.<sup>27</sup>

---

<sup>24</sup>U S West Response at 2, 6-7.

<sup>25</sup>Bell Atlantic North Audit Report at ¶ 20.

<sup>26</sup>Loebbecke Affidavit at ¶ 11.

<sup>27</sup>SBC indicates in its response (at 2-3) that the auditors rescored 35 items in SBC's favor. Similarly, Bell Atlantic indicates in its response (in Exhibit 3) that the auditors rescored 8 items from "not found" to "found" or "unverified" for Bell Atlantic-North and rescored 9 items from "not found" to "found," "found in a different location," or "unverifiable" for Bell Atlantic-South.

### **III. The Audit Scoring was Overly Generous to the RBOCs**

Contrary to the RBOC claim that the scoring standards used during the CPR audits were unreasonable, the scoring standards were, if anything, overly generous to the RBOCs. It is likely that a substantial portion of the CPR line items scored as “unverifiable” -- under the standards used by the auditors, items that “could not be verified with certainty” -- are, in fact, missing.

#### **A. Many of the Unverifiable Items are Likely to be Missing**

The auditors employed a scoring system in which items were “scored” to one of four categories: “1-found,” “2-found in a different location,” “3-not found,” and “4-unverifiable.”<sup>28</sup> For the audit reports, the items scored as a “2” or a “4” were combined into a single “unverifiable” category.

The auditors made liberal use of the “unverifiable” category; when they were shown equipment, but “it could not be verified with certainty,” it was classified as “unverifiable” rather than “not found.”<sup>29</sup> In fact, items were scored as “unverifiable” as long as “the possibility exist[ed] that the sampled listings . . . may be somewhere in the office.”<sup>30</sup> As a consequence of the broad definition of “unverifiable,” the “not found” category was defined extremely narrowly;<sup>31</sup> generally, a CPR line item was classified as

---

<sup>28</sup>Rescoring Public Notice at 1.

<sup>29</sup>Bell Atlantic North Audit Report at ¶ 21.

<sup>30</sup>Id., Appendix C, at 2 (emphasis added).

<sup>31</sup>Loebbecke Affidavit at ¶ 8.

“not found” only when the auditors were shown no equipment at all.<sup>32</sup> Overall, the auditors scored 17 percent of the sample items as “unverifiable,” while scoring only 8.5 percent of the sample items as “not found.”<sup>33</sup>

Given that the “unverifiable” items could not be verified with certainty, it is likely that a substantial portion of these items are in fact missing and should more properly have been scored as “not found.” Among other things:

- The auditors scored items as “unverified” even when they were shown the items in locations other than the one specified in the CPR.<sup>34</sup>
- The auditors scored items as “unverified” even when the items they were shown did not match the description in the CPR.<sup>35</sup>
- The auditors scored items as “unverified” even when the CPR line item was missing location or description information.<sup>36</sup>
- The auditors scored items as “unverified” even when there was clearly a shortage of the equipment type in question. There were cases when the auditors were shown sufficient quantities on the frame to match the line item on the

---

<sup>32</sup>Bell Atlantic North Audit Report at ¶18 (“Items were considered not found only when the sampled equipment could not be located anywhere in the central office.”)

<sup>33</sup>Appendix A.

<sup>34</sup>Audit Reports, Appendix C, p. 1.

<sup>35</sup>Id., p. 2.

<sup>36</sup>Id.

sample, but not to satisfy additional listings of similar equipment on the CPR that should also be on the frame.<sup>37</sup>

Due to the narrow definition of “not found,” the auditors’ estimates for the dollar value of missing equipment are extremely conservative. Only the “not found” item counts were taken into account when deriving the dollar value estimates;<sup>38</sup> the very large number of “unverifiable” items -- many of which are almost certainly missing -- were not reflected in the auditors’ calculation of the dollar value estimates.

#### **B. The Rescoring Process Favored the RBOCs**

Not only was the field audit scoring lenient, but the rescoring process was entirely one-way, in the RBOCs’ favor. The auditors considered only RBOC requests to “upgrade” scores in their favor, and did not investigate whether additional evidence would justify a “downgrading” of the scores. In particular, despite the considerable uncertainty surrounding the “unverifiable” items, the auditors did not attempt further investigations to determine if the “unverifiable” items should more properly have been scored as “not found.”

The standards that the auditors applied in their evaluation of the RBOC rescoring requests were reasonable in all respects.<sup>39</sup> The fact that few items were rescored is not

---

<sup>37</sup>Id.

<sup>38</sup>Bell Atlantic North Audit Report at ¶ 23.

<sup>39</sup>Loebbecke Affidavit at ¶ 12.



an indicator that the rescoring standards were too stringent, as some of the RBOCs suggest. The limited number of rescoring of “not found” items reflects, most importantly, the fact that a conscientious and search by the auditors and the RBOC engineers had been unable to find the sample item anywhere in the central office. Moreover, as a result of the lenient scoring during the field audits, there were few “close calls” that had not already been scored in the RBOCs’ favor.

The auditors recognized that there could be valid explanations, such as interim retirements, that would justify rescoring line items that could not be found on the day of the audit. The auditors required only that the RBOCs submit adequate original documentation to support their explanations -- documents such as purchase orders (to support claims that the CPR was in error, rather than that equipment was missing), retirement authorizations (to support interim retirement claims), telephone equipment orders (TEOs) ( to support claims that items had been moved to other locations), or engineering drawings (to support claims that items scored as “missing” were in fact embedded in other items.)<sup>40</sup>

It was reasonable for the auditors to require the RBOCs to support their explanations with such source documentation. First, Section 32.12(b) requires that companies file the detail records supporting all account entries “in such manner as to be readily accessible for examination by representatives of [the] Commission.”<sup>41</sup>

---

<sup>40</sup>Rescoring Public Notice at 2-4.

<sup>41</sup>47 C.F.R. § 32.12(b).

Furthermore, the documentation that the auditors accepted in support of rescoring requests consisted of precisely the types of records that the RBOCs are required to keep by the Part 32 property record rules.<sup>42</sup> The Commission's rules require that these records be maintained throughout the life of the property.<sup>43</sup>

### **C. RBOC Criticisms of the Scoring Standards are Without Merit**

As part of their effort to undermine the credibility of the audits, the RBOCs misrepresent the scoring standards used by the auditors in several respects.

#### **1. Items in Other Locations were not Scored as Missing**

One of the RBOCs' main criticisms of the auditors' scoring methodology is that "the audit staff reports generally . . . treat as 'missing' items that were found in the central office, but in a location that is different from the one specified in the detailed property record."<sup>44</sup> This claim misrepresents the auditors' treatment of these items.

The facts are:

1. The auditors used a scoring system in which items in locations other than the one specified in the CPR were scored as a "2-found in another location." These items

---

<sup>42</sup>Id., §§ 32.2000(e)(1), 32.2000(f)(8).

<sup>43</sup>Id., § 32.2000(e)(2).

<sup>44</sup>Bell Atlantic Response at 5-6.

were not scored as “3-not found.”<sup>45</sup> Items scored as “2-found in another location” were considered “unverifiable” for the purposes of the audit reports, and, as with other “unverifiable” items, were not reflected in the auditors’ estimates of the dollar value of “missing” equipment.

2. The auditors scored large numbers of items as “2-found in another location.” As is discussed in the audit reports, the auditors employed a variety of procedures to determine whether the items that they were shown in other locations had a significant possibility of being the sample CPR line item.<sup>46</sup> Contrary to Bell Atlantic’s claim that such procedures were used only “rarely,” the auditors scored over 500 sample items as “2-found in another location”:

**Table 1 -- Items Scored as “Found in Another Location”  
(Source: Audit Reports, Appendix C, p. 1)**

<u>Company</u>	<u># of Items</u>
Ameritech	122
BA-S	54
BA-N	57
BellSouth	52
Pacific	61
SWBT	77
U S West	79
<b>Total</b>	<b>502</b>

---

<sup>45</sup>Bell Atlantic North Audit Report at ¶ 18 (“Items were considered not found only when the sampled equipment could not be located anywhere in the central office.”)

<sup>46</sup>Bell Atlantic North Audit Report at ¶ 18, Appendix C at 1.

3. In addition to scoring a large number of items as “found in another location,” the auditors scored as “found” a large number of items for which the RBOC’s CPR showed no location information at all.<sup>47</sup> While the auditors could reasonably have scored all of these items as “not found,” the auditors employed a variety of procedures to investigate these items.<sup>48</sup>

4. In the limited number of cases in which the auditors scored items that they were shown in other locations as “not found,” this decision was based on evidence that indicated that the item the auditors were being shown could not be the sample line item. For example, if the auditors were shown a hard-wired COE item at a location other than the one specified in the CPR, but the CPR already listed an item of the same type at that location, the auditors reasonably concluded that the item they were being shown could not be the sample item.

5. The auditors’ practice of scoring items that they were shown in other locations as “2-found in another location” was generous to the RBOCs. The continuing property record system used by the RBOCs, PICS/DCPR, relies on location information to identify CPR line-items; the RBOCs’ property record system does not use bar codes or other unique identifiers.<sup>49</sup> If the equipment item cannot be found at the location specified in PICS/DCPR, there is no way to be sure that the equipment actually exists.

---

<sup>47</sup>Bell Atlantic North Audit Report at ¶21.

<sup>48</sup>Audit Reports, Appendix C at 1.

<sup>49</sup>GTE has recently implemented a bar code system for tracking its central office property items. See GTE CPR Audit, Joint Audit Report, Part IV (GTE Response) at 5-6.

Because location is the identifier, there can be no assurance that equipment of the same type at a different location is in fact the specific sample item that is the subject of the search.

## **2. Interim Retirements were Scored as “Found”**

The RBOCs also complain that they were unfairly penalized for equipment items that were retired between the time that the auditors obtained the property record listing and the date of the inspection. Bell Atlantic, for example, alleges that “the audit reports incorrectly classify these items as missing.”<sup>50</sup>

Contrary to Bell Atlantic’s claim, the auditors recognized that interim retirements would constitute a valid reason for rescoring.<sup>51</sup> The auditors required only that the RBOCs support their interim retirement claims with telephone equipment orders (TEOs) or other original documents authorizing and confirming the removal of the sample item.<sup>52</sup> Given that interim retirements were, by definition, recent events, the documentation should have been at hand.

The auditors correctly did not accept rescoring requests when the RBOC failed to provide adequate documentation to support an interim retirement claim, or when the RBOC’s explanation or documentation were inconsistent with an interim retirement. In particular, if the explanation or documentation suggested that the item had been removed

---

<sup>50</sup>Bell Atlantic Response at 5.

<sup>51</sup>Rescoring Public Notice at 3.

<sup>52</sup>Id.

from service before the audit and the RBOC had failed to record the retirement on the CPR, the Bureau auditors correctly left the initial scoring of “not found” unchanged.<sup>53</sup> Even if such items had been in service at some point in the past, a failure to record retirements meant that the RBOC’s books showed investment for items that were no longer used and useful in the provision of telecommunications service. A failure to record retirements is, moreover, a violation of Section 32.2000(d) of the Commission’s rules.<sup>54</sup>

### **3. The RBOCs were not Penalized for Embedded Items**

Several RBOCs also suggest that they were penalized for items that could not be seen because they were “embedded” in a larger item.<sup>55</sup> To the contrary, such items were scored at least as “unverified” as long as the RBOC engineers made a credible claim during the field audit that the sample item was embedded in the larger item.<sup>56</sup> If the RBOC engineers provided a drawing or schematic on the day of the audit, such items were scored as “found.” If the RBOC provided a drawing or schematic during the rescoring phase, such items were rescored in favor of the RBOC. In no case where a credible claim was made that an item was embedded was the item scored as “not found.”

---

<sup>53</sup>Id. at 4.

<sup>54</sup>47 C.F.R. §32.2000(d).

<sup>55</sup>See, e.g., Bell Atlantic Response at 5.

<sup>56</sup>Rescoring Public Notice at 4.

#### 4. CPR Misstatements

During the rescoring phase, several RBOCs claimed that sample items were scored as “not found” because the CPR listing was in error. For example, in cases where the auditors were unable to find the quantity shown in the CPR, the RBOC would contend that the quantity had been entered incorrectly in the CPR.<sup>57</sup> In other cases, the RBOC would contend that the auditors had been unable to find the sample item because the description shown in the CPR was incorrect.<sup>58</sup>

Under the auditors’ rescoring standards, such sample items were rescored in the RBOC’s favor if the RBOC could provide documentation to show that a recording error had occurred.<sup>59</sup> The auditors would rescore the item if the company provided original invoices that matched the CPR detail in all respects, except that the quantity (or description) matched the “correct” quantity (or description) claimed by the RBOC. The Commission’s property record rules require the RBOCs to maintain such documentation.

Even if the RBOC was unable to provide these invoices, the auditors went to great lengths in their attempts to verify quantity recording error claims. For example, the auditors researched the per-unit costs of the equipment type in question to determine whether the material cost shown on the CPR was consistent with the lower quantity

---

<sup>57</sup>See, e.g., Bell Atlantic Response at 7.

<sup>58</sup>*Id.*, at 6-7.

<sup>59</sup>Rescoring Public Notice at 2-3.

claimed by the RBOC.<sup>60</sup> If this was the case, the auditors generally rescored the “not found” designation.

**D. Rearrangements of the Scoring System after the Field Audits Did Not Result in Substantive Changes to the Scores**

During the field audit, the “4-unverifiable” category had a number of subcategories. After the field audits were complete, the auditors rearranged the scoring categories to assign the 4(f), 4(g), and 4(c) subcategories to other categories. In particular, the auditors reassigned the 4(f) and 4(g) “unverifiable -- quantity shortage” subcategories to “3-not found,” to better reflect the fact that the 4(f) and 4(g) categories included missing equipment. The 4(c) “unverifiable -- probable find” subcategory was reassigned to “1-found.”

The reassignment of the 4(f) and 4(g) “quantity shortage” items to “3-not found” was not a sinister “behind closed doors” process that resulted in a “massive downgrade” of the scores, as Bell Atlantic claims.<sup>61</sup> The change in the scoring system simply grouped together in a single category all of the missing items, both the items that were partially “not found” and the items that were entirely “not found.” It did not involve any increase in the number of items considered missing.

---

<sup>60</sup>Rescoring Public Notice at 3.

<sup>61</sup>See, e.g., Bell Atlantic Response at 10.



#### **IV. The Audit Reports' Statistical Extrapolations are Valid and Support the Audit Reports' Conclusions**

The audit reports draw valid statistical inferences concerning the proportion of incorrect line items in the RBOCs' CPR and the dollar value of missing equipment. These estimates show that the RBOCs have not maintained their property records in a manner consistent with the Commission's rules, and that the RBOCs' COE plant balances are overstated by billions of dollars.<sup>62</sup>

The RBOCs devote a great deal of energy to attacking the audit reports' statistical methodologies, but completely fail to undermine the reports' conclusions. In fact, the RBOCs' alternate approaches for calculating the point estimates and the 95 percent confidence intervals arrive at much the same results as the audit reports -- as long as they use the actual audit results. The very low estimated values of missing equipment that some of the RBOCs cite in their responses to the audit reports are based not on the actual audit results, but on a completely hypothetical rewriting of the audit scores.<sup>63</sup> Thus, the RBOCs' main argument -- that the amount of missing equipment may be small or even zero -- is essentially an attack on the scoring of the field audits, not on the statistical calculations.

Specifically, the RBOCs find no basis to challenge the point estimates shown in the audit reports. As is pointed out in the Affidavit of Dr. Robert M. Bell (Bell Affidavit), attached to AT&T's comments in this proceeding, the audit reports' point

---

<sup>62</sup>Bell Atlantic North Audit Report at ¶ 2.

<sup>63</sup>See, e.g., Ameritech Response, Appendix A-1, at 4; Bell Atlantic Response, Appendix A, at 24.